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2012

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### Recommended Citation

David R. Hague, What Every Guarantor Should Know About the One-Action Rule and Deficiency Actions, *The Enterprise* (April 2012).

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# THE Enterprise

## UTAH'S BUSINESS JOURNAL

www.slenterprise.com

April 9-15, 2012

Volume 41, Number 37

\$1.50

## What every guarantor should know about the one-action rule and deficiency actions

Personal guarantees are an inherent part of obtaining a business loan. A personal guarantee is an unsecured promise from an individual (typically an individual who is closely associated with the business trying to obtain the loan) to make loan payments when the business is not able to do so. In other words, it is simply an added assurance for the lender that the loan will be paid in full. Generally, if the borrower defaults, the lender can file suit against both the borrower and the guarantor for payment.

Oftentimes, lenders require another layer of protection, in addition to the personal guarantee: collateral to secure the loan. A secured loan is simply a loan in which the borrower pledges some asset as collateral for the loan, which then becomes a secured debt. This collateral can be anything from equipment, accounts receivable or deposit accounts, to name a few. But the most common form of collateral to a secure a business loan — especially if the business loan is of a sizeable magnitude — is real property.

In Utah, the majority of loans that involve real property are secured by a deed of trust, commonly referred to as a trust deed, as opposed to a traditional mortgage. A trust deed is similar to a mortgage in that both are encumbrances on real property to secure a loan or other obligation. But one key difference is that a trust deed can be foreclosed by the trustee who has the power to sell the property without filing a lawsuit. This is called a non-judicial foreclosure or a power of sale foreclosure.

As real estate loses its value, however, some lenders are seeking judgments against guarantors instead of proceeding first against the principal borrower and the property securing the borrower's obligation. When this occurs, two important rules under Utah law become applicable and could make the difference in the guarantor's fight against the lender. The first rule is commonly referred to as the "one-action rule." The second rule deals with the protections under what is known as the "deficiency" statute.

Many states have enacted statutes known as "one-action" rules, which limit a

lender to only one action for the recovery of any debt secured by a lien on real property. These rules are best viewed as "security first" requirements, under which a lender must exhaust the security before recovering from the borrower personally. In Utah,



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the statute provides that "[t]here is only one action for the recovery of any debt, or the enforcement of any right, secured solely by mortgage upon real estate and that action shall be in accordance with the provisions of this chapter." The Utah Supreme Court has interpreted this statute as preventing a lender from suing the borrower personally on the note until it first forecloses against the real property. And while the statute uses the word "mortgage," the

Utah Supreme Court has also recognized the statute's applicability to trust deeds. The one-action rule advances two purposes. First, it minimizes the borrower's liability by forcing the lender to look first to the security before suing the borrower, and it attempts to eliminate multiple lawsuits.

In some jurisdictions, the one-action rule extends to a guarantor of debt, but in Utah, a lender is not required to resort to collateral security before seeking judgment against a guarantor. In a lender's action against a guarantor to recover on a loan, the Utah Supreme Court held that a creditor need not foreclose on a trust deed prior to seeking recovery from a guarantor of payment. Since guarantees are meant to protect the creditor, the court held that applying the one-action rule to actions against guarantors unnecessarily limits the parties' ability to allocate risk and undermines the primary purpose of guarantees of payment.

The above holding represents an enormous risk to guarantors. Indeed, it is not uncommon for guarantors to sign unconditional guarantee agreements with the assumption that the real property securing the underlying loan will serve as a partial shield to their legal obligation to repay the lender. Under Utah law, such reasoning is faulty. While other defenses against the lender might be available to the guarantor, standing behind the real property is not one of them. On the other hand, while a lender may proceed directly against a guarantor

of payment without first foreclosing on the trust deed, if the lender elects to seek foreclosure, it must do so in accordance with the procedure set forth in the Utah Trust Deed Act.

In most cases, a foreclosure sale does not generate sufficient proceeds to fully pay the entire indebtedness for which the trust deed was conveyed as security. When that happens, the lender may file a lawsuit against the borrower and guarantor to recover any remaining balance due. The remaining balance due after foreclosure is called a "deficiency," and the lawsuit to recover that deficiency is called a "deficiency action."

Section 57-1-32 provides the only mechanism for obtaining recovery of the remaining balance due. Under Utah law, a deficiency action must be filed within three months after the non-judicial foreclosure sale. The lender must plead the entire amount of the indebtedness that was secured by the trust deed, the amount for which the property was sold, and the fair market value of the property at the date of sale. This prevents lenders from obtaining excessive recoveries against the borrowers for the deficiency amount. The court in which the action is filed may not render a judgment for more than the amount by which the amount of the indebtedness with interest, costs and expenses of sale, including trustee's and attorney's fees, exceeds the fair market value of the property as of the date of the sale. Utah courts have stated that the purpose of the fair market value provision is to protect the borrower, who in a non-judicial foreclosure has no right of redemption, from a lender who could purchase the property at the sale for a low price and then hold the borrower liable for a larger deficiency.

In another case, the Utah Supreme Court concluded that the Utah Trust Deed Act protects more than just the borrowers — it protects all parties, including guarantors, who may be liable for a deficiency. Thus, section 57-1-32 also provides the exclusive procedure to recover from a guarantor the balance due on a trust deed following foreclosure. As long as the lender brings an action to recover the balance due on the indebtedness secured by a trust deed, the Utah Trust Deed Act provides the only mechanism for recovering the deficiency and guarantors are clearly protected by the

act's three-month statute of limitations and its fair market value requirement.

There is no doubt that personal guarantees will always be part of the business-loan process. The majority of small-business loans require personal guarantees from business owners. A personal guarantee demonstrates that you are serious about your business — and most importantly — serious about repaying the loan. One court decision has created a new risk for guarantors who have guaranteed debts secured by real property. The Utah Supreme Court has ruled that the plain language of the one-action rule does not mandate its applications to guarantors, and construing the statute to do so would not further the purpose the rule was intended to serve. On the other hand, guarantors are protected by the deficiency procedures set forth in the Utah Trust Deed Act. Upon conclusion of a trustee's sale, a creditor simply may not recover any balance from a guarantor unless it satisfactorily complies with section 57-1-32.

Signing a personal guarantee comes with substantial risks, primarily related to your obligation to repay the business loan and the lender's legal right to go after you and your personal assets if the business defaults. Think twice about providing your personal guarantee, particularly when you believe that it is not a prerequisite to obtaining a business loan. If your business is strong financially or it can offer the lender collateral to protect the loan, the lender may consider waiving the personal guarantee requirement. When faced with signing a personal guarantee, you should carefully review the personal guarantee agreement and have a lawyer review all the paperwork involved.

David Hague is a shareholder at Fabian and chair of the firm's bankruptcy practice group. Hague practices primarily in the areas of bankruptcy law and commercial litigation. He has extensive experience representing secured and unsecured creditors, debtors and debtors-in-possession, and Chapter 7 and 11 trustees in complex bankruptcy cases. He also represents clients in the areas of equipment leasing, collection law, secured transactions, ERISA litigation, and employment law. Hague can be reached at (801) 531-8900 or dhague@fabianlaw.com.